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SUBJECT: Petrobras Launches Biofuels Subsidiary

¶1. Summary. This week, Brazil's semi-public oil company Petrobras will launch a new subsidiary to run its growing biofuels operations, looking towards building production capacity to meet growing global demand for ethanol exports. The new subsidiary, called Petrobras Biocombustivel, will coordinate Petrobras' significant biofuels investments (US\$1.5 billion over five years) which are currently run by various units of the company. Through joint ventures with foreign investors, Petrobras plans to buy minority stakes in ethanol mills in Brazil and abroad, with an eye towards markets such as Venezuela, Japan and the U.S. End Summary.

Introducing Petrobras Biocombustivel

¶2. Petrobras is launching a biofuels subsidiary this week, Petrobras Biocombustivel, to oversee over US\$ 1.5 billion in new biofuels investments. Petrobras Biocombustivel, headed by longtime Petrobras insider Alan Kardec Pinto, will partner with foreign investors to buy minority stakes in ethanol projects in Brazil and abroad, aiming at ensuring supplies for Petrobras's projected export supply contracts. Mines and Energy Minister Edison Lobao will be at the New York Stock Exchange on August 18th to ring the closing bell as a means of announcing this new subsidiary. By 2012, Petrobras expects most of its ethanol exports will come from the mills where it holds minority stakes with an annual ethanol output of 1.3 billion gallons.

¶3. Petrobras Biocombustivel's primary focus will be on ethanol and biodiesel production, as well as expansion of the company's ethanol pipeline and storage facilities. It will also oversee three biodiesel plants that are scheduled to come on-line later in 2008. The biodiesel plants, at a combined cost of US\$188 million, will each produce 45 million gallons of biodiesel annually for domestic consumption.

Snapshot of Petrobras' Current Biofuels Operations

¶4. Petrobras is a strong player in ethanol transport (Note: Petrobras controls the country's pipeline which is used for ethanol transportation) and distribution in Brazil's domestic market, but it is not currently an ethanol producer. Through its distribution unit, Petrobras Distribuidora, the company buys ethanol from Brazilian sugar-cane refiners and sells it at its service stations either as pure ethanol or as part of its gasoline and diesel mixtures. (Note: By law, more than a fifth of all gasoline sold in Brazil contains ethanol and ethanol just displaced gasoline as the major automotive fuel earlier this year.) Petrobras stations currently sell over one-third of the ethanol used as fuel in Brazil. Since July 1, 2008, all diesel fuel in Brazil contains 3 percent biodiesel (supplied by Petrobras).

¶5. In 2007, Petrobras exported about 210 million gallons of ethanol. Its only current ethanol export client is Petroleos de Venezuela (PDVSA), Venezuela's state oil company. PDVSA imports ethanol as a replacement for tetra-ethyl lead, a toxic gasoline additive. Outside of Venezuela (and potentially the U.S.),

Petrobras sees Japan as a critical market for its expanded ethanol export strategy. In late 2007, Petrobras entered into its first five joint venture partnerships to produce ethanol in the states of Goias and Mato Grosso. In Petrobras's first partnership with Mitsui, Japan's second-largest trading company, each company bought 10 percent of a mill that will start producing about 53 million gallons of ethanol annually in 2009.

Comment

¶6. Despite Petrobras' bright ethanol exports forecast in the long term, this year's overseas sales will fall short of its goal, due mainly to Venezuela's shift to an oil-based additive in gasoline instead of Brazilian ethanol. Petrobras may also fall short of its export targets as countries including Japan, which the company counts on to buy most of its biofuels exports, delay plans for mandatory blending of ethanol into gasoline. A consulate contact described Petrobras Biocombustivel as a "pet project" of the Lula government driven primarily by the administration's "obsession" with ethanol. Petrobras is first and foremost an oil company, the source said, but the new subsidiary will at least serve to centralize the company's biofuels activities - which, up to now, have been spread out over several divisions and will compete with many firms which specialize in biofuels.

¶7. This cable has been coordinated with and cleared by Embassy Brasilia.

MARTINEZ